
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-33387

GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

77-0398779
(IRS Employer Identification No.)

1213 Elko Drive
Sunnyvale, California 94089
(Address of principal executive offices, zip code)

(408) 331-8800
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant's common stock outstanding as of January 31, 2017: 20,383,726

GSI TECHNOLOGY, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2016

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PART I — FINANCIAL INFORMATION**Item 1. Financial Statements****GSI TECHNOLOGY, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	December 31, 2016	March 31, 2016
	(In thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 30,495	\$ 31,963
Short-term investments	16,510	23,149
Accounts receivable, net	7,059	7,478
Inventories	9,243	7,174
Prepaid expenses and other current assets	3,160	2,198
Total current assets	<u>66,467</u>	<u>71,962</u>
Property and equipment, net	7,929	8,653
Long-term investments	14,122	11,148
Goodwill	7,978	8,030
Intangible assets, net	3,381	3,651
Other assets	2,461	3,086
Total assets	<u>\$ 102,338</u>	<u>\$ 106,530</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	\$ 2,127	\$ 2,514
Accrued expenses and other liabilities	6,379	4,398
Deferred revenue	2,211	2,330
Total current liabilities	<u>10,717</u>	<u>9,242</u>
Income taxes payable	242	116
Long-term deferred income taxes	—	811
Other accrued expenses	5,136	6,492
Total liabilities	<u>16,095</u>	<u>16,661</u>
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock: \$0.001 par value authorized: 5,000,000 shares; issued and outstanding: none	—	—
Common Stock: \$0.001 par value authorized: 150,000,000 shares; issued and outstanding: 20,360,401 and 21,716,364 shares, respectively	20	22
Additional paid-in capital	20,267	25,050
Accumulated other comprehensive income (loss)	(48)	27
Retained earnings	66,004	64,770
Total stockholders' equity	<u>86,243</u>	<u>89,869</u>
Total liabilities and stockholders' equity	<u>\$ 102,338</u>	<u>\$ 106,530</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands, except per share amounts)			
Net revenues	\$ 11,484	\$ 12,921	\$ 37,788	\$ 40,523
Cost of revenues	4,989	6,535	17,228	19,925
Gross profit	6,495	6,386	20,560	20,598
Operating expenses:				
Research and development	3,813	2,782	11,594	8,720
Selling, general and administrative	2,448	5,164	7,963	14,743
Total operating expenses	6,261	7,946	19,557	23,463
Income (loss) from operations	234	(1,560)	1,003	(2,865)
Interest income, net	81	78	227	229
Other income (expense), net	(20)	11	68	(45)
Income (loss) before income taxes	295	(1,471)	1,298	(2,681)
Provision (benefit) for income taxes	(53)	(652)	64	(598)
Net income (loss)	\$ 348	\$ (819)	\$ 1,234	\$ (2,083)
Net income (loss) per share:				
Basic	\$ 0.02	\$ (0.04)	\$ 0.06	\$ (0.09)
Diluted	\$ 0.02	\$ (0.04)	\$ 0.06	\$ (0.09)
Weighted average shares used in per share calculations:				
Basic	20,300	22,612	20,707	22,743
Diluted	21,097	22,612	21,239	22,743

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2016	2015	2016	2015
	(In thousands)			
Net income (loss)	\$ 348	\$ (819)	\$ 1,234	\$ (2,083)
Net unrealized loss on available-for-sale investments, net of tax	(65)	(68)	(76)	(85)
Total comprehensive income (loss)	<u>\$ 283</u>	<u>\$ (887)</u>	<u>\$ 1,158</u>	<u>\$ (2,168)</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended December	
	2016	2015
	31,	
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$ 1,234	\$ (2,083)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Allowance for sales returns, doubtful accounts and other	3	(3)
Provision for excess and obsolete inventories	491	914
Depreciation and amortization	1,189	1,037
Stock-based compensation	1,359	1,387
Amortization of premium on investments	52	177
Changes in assets and liabilities:		
Accounts receivable	416	(394)
Inventory	(2,560)	55
Prepaid expenses and other assets	(286)	(364)
Accounts payable	(387)	(726)
Accrued expenses and other liabilities	(60)	(2,278)
Deferred revenue	(119)	(873)
Net cash provided by (used in) operating activities	<u>1,332</u>	<u>(3,151)</u>
Cash flows from investing activities:		
Purchase of investments	(14,062)	(12,526)
Sales and maturities of short-term investments	17,600	21,335
Acquisition	—	(4,359)
Restricted cash	—	(2,984)
Purchases of property and equipment	(194)	(1,101)
Net cash provided by investing activities	<u>3,344</u>	<u>365</u>
Cash flows from financing activities:		
Repurchase of common stock	(7,112)	(4,083)
Proceeds from issuance of common stock under employee stock plans	968	818
Net cash used in financing activities	<u>(6,144)</u>	<u>(3,265)</u>
Net decrease in cash and cash equivalents	(1,468)	(6,051)
Cash and cash equivalents at beginning of the period	31,963	36,776
Cash and cash equivalents at end of the period	<u>\$ 30,495</u>	<u>\$ 30,725</u>
Supplemental cash flow information:		
Net cash paid for income taxes	<u>\$ 1,341</u>	<u>\$ 78</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

GSI TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries (“GSI” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

The consolidated results of operations for the nine months ended December 31, 2016 are not necessarily indicative of the results to be expected for the entire fiscal year.

Significant accounting policies

The Company’s significant accounting policies are disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

Recent accounting pronouncements

In November 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-18, “*Statement of Cash Flows (Topic 230): Restricted Cash*”. ASU 2016-18 requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact this new guidance will have on its consolidated statement of cash flows

In October 2016, the FASB issued ASU 2016-16, “*Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*.” ASU 2016-16 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs and eliminates the exception for an intra-entity transfer of an asset other than inventory. ASU 2016-16 is effective for annual and interim periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods, and is required to be adopted using a modified retrospective approach, with early adoption permitted. The Company is evaluating the impact of the adoption of this ASU on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*”. ASU 2016-15 adds or clarifies guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. The amendments in the update provide guidance on eight specific cash flow issues, and are effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The amendments to the guidance should be applied using a retrospective transition method for each period presented and, if it is

impracticable to apply all of the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company is currently evaluating the impact this new guidance will have on its consolidated statement of cash flows.

In June 2016, the FASB issued ASU 2016-13, "*Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*," ASU 2016-13 replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The new standard will be effective for the Company beginning April 1, 2020, with early adoption permitted beginning April 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "*Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This accounting standard update will be effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, and early adoption is permitted. The Company is currently evaluating the methods and impact of adopting the new accounting standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "*Leases (Topic 842)*." The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, "*Elements of Financial Statements*," and, therefore, recognition of those lease assets and lease liabilities represents a change of previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. This ASU is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Although the Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In January 2016, the FASB issued ASU 2016-01, "*Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*." ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. This accounting standard update will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

In September 2015, the FASB issued a new accounting standard that eliminates the requirement to restate prior period financial statements for measurement period adjustments following a business combination. The new guidance requires that the cumulative impact of a measurement period adjustment including the impact on prior periods be recognized in the reporting period in which the adjustment is identified along with additional disclosures. The new guidance was effective for the Company beginning in the first quarter of fiscal 2017. Implementation of this new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, "*Simplifying the Measurement of Inventory*." This standard update intends to simplify the subsequent measurement of inventory, excluding inventory accounted for under the last-in, first-out or the retail inventory methods. The update replaces the current lower of cost or market

test with a lower of cost and net realizable value test. Under the current guidance, market could be replacement cost, net realizable value or net realizable value less an approximately normal profit margin. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The update is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact of this accounting standard on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "*Presentation of Financial Statements - Going Concern.*" The amendment requires that an entity's management evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. If conditions or events raise substantial doubt about an entity's ability to continue as a going concern additional disclosure is required to enable users of the financial statements to understand the conditions or events, management's evaluation of the significance of those conditions and management's plans to that are intended to alleviate or management's plans that have alleviated substantial doubt. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "*Revenue from Contracts with Customers.*" The new accounting standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The accounting standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. Early adoption is permitted for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. ASU No. 2014-09 provides for one of two methods of transition: retrospective application to each prior period presented; or recognition of the cumulative effect of retrospective application of the new standard in the period of initial application. The Company is currently evaluating the full impact of this new guidance on its consolidated financial statements, including selection of the transition method. However, assuming all other revenue recognition criteria have been met, it is likely that the new guidance would require the Company to recognize revenue and cost relating to distributor sales upon product delivery, subject to estimated allowance for distributor price adjustments and rights of return. In March, April and May 2016, the FASB issued additional updates to the new revenue standard relating to reporting revenue on a gross versus net basis, identifying performance obligations and licensing arrangements, and narrow-scope improvements and practical expedients, respectively. The Company is in the process of assessing the impact this additional guidance is expected to have upon adoption, including determining the adoption method.

NOTE 2—NET INCOME (LOSS) PER COMMON SHARE

The Company uses the treasury stock method to calculate the weighted average shares used in computing diluted net income (loss) per share. The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands, except per share amounts)			
Net income (loss)	\$ 348	\$ (819)	\$ 1,234	\$ (2,083)
Denominators:				
Weighted average shares—Basic	20,300	22,612	20,707	22,743
Dilutive effect of employee stock options	795	—	530	—
Dilutive effect of employee stock purchase plan options	2	—	2	—
Weighted average shares—Dilutive	21,097	22,612	21,239	22,743
Net income (loss) per common share—Basic	\$ 0.02	\$ (0.04)	\$ 0.06	\$ (0.09)
Net income (loss) per common share—Diluted	\$ 0.02	\$ (0.04)	\$ 0.06	\$ (0.09)

The following shares of common stock underlying outstanding stock options, determined on a weighted average basis, were excluded from the computation of diluted net income (loss) per share as they had an anti-dilutive effect:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands)			
Shares underlying options	4,621	5,887	5,247	5,282

NOTE 3—BALANCE SHEET DETAIL

	<u>December 31,</u> <u>2016</u>	<u>March 31, 2016</u>
	(In thousands)	
Inventories:		
Work-in-progress	\$ 2,551	\$ 1,697
Finished goods	6,317	5,011
Inventory at distributors	375	466
	<u>\$ 9,243</u>	<u>\$ 7,174</u>

	<u>December 31,</u> <u>2016</u>	<u>March 31, 2016</u>
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	\$ 7,162	\$ 7,578
Less: Allowances for sales returns, doubtful accounts and other	(103)	(100)
	<u>\$ 7,059</u>	<u>\$ 7,478</u>

	<u>December 31,</u> <u>2016</u>	<u>March 31, 2016</u>
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid tooling and masks	\$ 1,021	\$ 1,224
Prepaid income taxes	43	—
Escrow deposit	1,234	—
Other receivables	306	230
Other prepaid expenses and other current assets	556	744
	<u>\$ 3,160</u>	<u>\$ 2,198</u>

	<u>December 31,</u> <u>2016</u>	<u>March 31, 2016</u>
	(In thousands)	
Property and equipment, net:		
Computer and other equipment	\$ 18,560	\$ 18,394
Software	4,793	4,793
Land	3,900	3,900
Building and building improvements	2,256	2,256
Furniture and fixtures	110	114
Leasehold improvements	715	687
	<u>30,334</u>	<u>30,144</u>
Less: Accumulated depreciation	(22,405)	(21,491)
	<u>\$ 7,929</u>	<u>\$ 8,653</u>

Depreciation expense was \$289,000 and \$322,000, respectively, for the three months ended December 31, 2016 and 2015 and \$919,000 and \$892,000, respectively, for the nine months ended December 31, 2016 and 2015.

	December 31, 2016	March 31, 2016
	(In thousands)	
Other assets:		
Escrow deposit	\$ 1,750	\$ 2,984
Non-current deferred income taxes	23	—
Prepaid income taxes	563	—
Deposits	125	102
	<u>\$ 2,461</u>	<u>\$ 3,086</u>

The escrow deposits at December 31, 2016 and March 31, 2016 include approximately \$1.8 million and \$3.0 million, respectively, placed in escrow in connection with the Company's acquisition of MikaMonu Group Ltd. on November 23, 2015. See Note 10— Acquisition for more information.

The following tables summarize the components of intangible assets and related accumulated amortization balances at December 31, 2016 and March 31, 2016 (in thousands):

	As of December 31, 2016		
	Gross Carrying Amount	Accumulated amortization	Net Carrying Amount
Intangible assets:			
Product designs	\$ 590	\$ (590)	\$ —
Patents	4,220	(839)	3,381
Software	80	(80)	—
Total	<u>\$ 4,890</u>	<u>\$ (1,509)</u>	<u>\$ 3,381</u>

	As of March 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:			
Product designs	\$ 590	\$ (555)	\$ 35
Patents	4,220	(604)	3,616
Software	80	(80)	—
Total	<u>\$ 4,890</u>	<u>\$ (1,239)</u>	<u>\$ 3,651</u>

Amortization of intangible assets included in cost of revenues was \$78,000 and \$63,000, respectively, for the three months ended December 31, 2016 and 2015 and \$270,000 and \$145,000, respectively, for the nine months ended December 31, 2016 and 2015.

As of December 31, 2016, the estimated future amortization expense of intangible assets in the table above is as follows (in thousands):

Twelve month period ending December 31,	
2017	\$ 313
2018	287
2019	233
2020	233
2021	233
Thereafter	2,082
Total	<u>\$ 3,381</u>

	December 31, 2016	March 31, 2016
	(In thousands)	
Accrued expenses and other liabilities:		
Accrued compensation	\$ 3,237	\$ 3,082
Escrow indemnity accrual	484	—
Accrued professional fees	34	83
Accrued commissions	235	284
Contingent consideration	1,114	—
Accrued retention payment	205	—
Miscellaneous accrued expenses	1,070	949
	<u>\$ 6,379</u>	<u>\$ 4,398</u>

	December 31, 2016	March 31, 2016
	(In thousands)	
Other accrued expenses:		
Contingent consideration	\$ 4,862	\$ 5,856
Escrow indemnity accrual	—	484
Other long-term accrued liabilities	274	152
	<u>\$ 5,136</u>	<u>\$ 6,492</u>

NOTE 4—GOODWILL

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed in a business combination. The Company tests for goodwill impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. The Company has one reporting unit. The Company assesses goodwill for impairment on an annual basis on the last day of February in the fourth quarter of its fiscal year.

The Company had a goodwill balance of \$8.0 million as of both March 31, 2016 and December 31, 2016. The goodwill resulted from the acquisition of MikaMonu Group Ltd. (“MikaMonu”) in fiscal 2016. The slight reduction in goodwill at December 31, 2016 was due to additional tax liabilities identified as of the acquisition date in the amount of \$52,000.

The Company utilized a two-step quantitative analysis to complete its annual impairment test during the fourth quarter of fiscal 2016 and concluded that there was no impairment, as the fair value of its sole reporting unit exceeded its carrying value. The Company determined that the second step of the impairment test was not necessary. No triggering event took place subsequent to the fiscal 2016 annual assessment that necessitated a quantitative impairment analysis for the Company’s one reporting unit. However, there continues to be a risk that a sustained decline in the Company’s stock price could constitute a triggering event that would require assessment for potential goodwill impairment in fiscal 2017.

NOTE 5—INCOME TAXES

The current portion of the Company’s unrecognized tax benefits was \$0 at both December 31, 2016 and March 31, 2016. The long-term portion at December 31, 2016 and March 31, 2016 was \$242,000 and \$116,000, respectively, of which the timing of the resolution is uncertain. As of December 31, 2016, \$2.2 million of unrecognized tax benefits had been recorded as a reduction to net deferred tax assets. As of December 31, 2016 and March 31, 2016, the Company’s net deferred tax assets of \$8.2 million and \$6.4 million, respectively, were subject to a full valuation allowance.

The Company recorded a net deferred tax liability of \$821,000 associated with the estimated fair value adjustments of the intangible assets acquired in its acquisition of MikaMonu in the quarter ended December 31,

2015. During the nine months ended December 31, 2016, the Company reversed the deferred tax liability and recorded a prepaid asset of \$637,000 associated with the transfer of the acquired intangible assets out of Israel.

Management believes that it is reasonably possible that within the next twelve months the Company could have a reduction in uncertain tax benefits of up to \$307,000, including interest and penalties, related to positions taken with respect to credits and loss carryforwards on previously filed tax returns.

The Company's policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the Condensed Consolidated Statements of Operations.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Fiscal years 2013 through 2016 remain open to examination by federal tax authorities, and fiscal years 2012 through 2016 remain open to examination by California tax authorities.

The Company's estimated annual effective income tax rate was approximately 7.4% and 9.6% as of December 31, 2016 and 2015, respectively. The annual effective tax rates as of December 31, 2016 and 2015 vary from the United States statutory income tax rate primarily due to valuation allowances in the United States, whereby pre-tax losses do not result in the recognition of corresponding income tax benefits and expenses, and the foreign tax differential.

NOTE 6—FINANCIAL INSTRUMENTS

Fair value measurements

Authoritative accounting guidance for fair value measurements provides a framework for measuring fair value and related disclosures. The guidance applies to all financial assets and financial liabilities that are measured on a recurring basis. The guidance requires fair value measurement to be classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. As of December 31, 2016, the Level 1 category included money market funds of \$3.8 million, which were included in cash and cash equivalents on the Condensed Consolidated Balance Sheets.

Level 2: Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well established independent pricing vendors and broker-dealers. As of December 31, 2016, the Level 2 category included short-term investments of \$16.5 million and long-term investments of \$14.1 million, which were comprised of certificates of deposit, corporate debt securities and government and agency securities.

Level 3: Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing. As of December 31, 2016, the Company had no Level 3 financial assets and a Level 3 financial liability consisting of the contingent consideration liability for the acquisition of MikaMonu. See Note 10-Acquisition for more information.

The fair value of financial assets measured on a recurring basis is as follows (in thousands):

	December 31, 2016	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	\$ 3,801	\$ 3,801	\$ —	\$ —
Marketable securities	30,632	—	30,632	—
Total	\$ 34,433	\$ 3,801	\$ 30,632	\$ —

	March 31, 2016	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	\$ 6,611	\$ 6,611	\$ —	\$ —
Marketable securities	34,297	—	34,297	—
Total	\$ 40,908	\$ 6,611	\$ 34,297	\$ —

Short-term and long-term investments

All of the Company’s short-term and long-term investments are classified as available-for-sale. Available-for-sale debt securities with maturities greater than twelve months are classified as long-term investments when they are not intended for use in current operations. Investments in available-for-sale securities are reported at fair value with unrecognized gains (losses), net of tax, as a component of accumulated other comprehensive income (loss) in the Condensed Consolidated Balance Sheets. The Company had money market funds of \$3.8 million and \$6.6 million at December 31, 2016 and March 31, 2016, respectively, included in cash and cash equivalents on the Condensed Consolidated Balance Sheets. The Company monitors its investments for impairment periodically and records appropriate reductions in carrying values when declines are determined to be other-than-temporary.

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The following table summarizes the Company's available-for-sale investments:

	December 31, 2016			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Short-term investments:				
Corporate notes	\$ 2,251	\$ 1	\$ —	\$ 2,252
Certificates of deposit	12,250	11	(3)	12,258
Foreign government obligations	1,001	—	(2)	999
Agency bonds	1,000	1	—	1,001
Total short-term investments	\$ 16,502	\$ 13	\$ (5)	\$ 16,510
Long-term investments:				
Corporate notes	\$ 557	\$ —	\$ (2)	\$ 555
Certificates of deposit	6,500	8	(29)	6,479
Foreign government obligations	3,445	—	(10)	3,435
State and municipal obligations	1,648	—	(1)	1,647
Agency bonds	2,014	—	(8)	2,006
Total long-term investments	\$ 14,164	\$ 8	\$ (50)	\$ 14,122

	March 31, 2016			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Short-term investments:				
State and municipal obligations	\$ 1,011	\$ —	\$ —	\$ 1,011
Corporate notes	5,680	—	(3)	5,677
Agency bonds	2,001	1	—	2,002
Foreign government obligations	2,695	3	—	2,698
Certificates of deposit	11,750	12	—	11,762
Total short-term investments	\$ 23,137	\$ 16	\$ (3)	\$ 23,150
Long-term investments:				
Corporate notes	\$ 558	\$ 1	\$ —	\$ 559
Certificates of deposit	8,500	24	(1)	8,523
Agency bonds	1,000	4	—	1,004
Foreign government obligations	1,060	1	—	1,061
Total long-term investments	\$ 11,118	\$ 30	\$ (1)	\$ 11,147

The Company's investment portfolio consists of both corporate and governmental securities that have a maximum maturity of three years. All unrealized gains and losses are due to changes in interest rates and bond yields. Subject to normal credit risks, the Company has the ability to realize the full value of all these investments upon maturity.

The deferred tax asset related to unrecognized gains and losses on short-term and long-term investments was \$12,000 at December 31, 2016. The deferred tax liability related to unrecognized gains and losses on short-term and long-term investments was \$14,000 at March 31, 2016.

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As of December 31, 2016, contractual maturities of the Company's available-for-sale investments were as follows:

	Cost	Fair Value
	(In thousands)	
Maturing within one year	\$ 16,502	\$ 16,510
Maturing in one to three years	14,164	14,122
	<u>\$ 30,666</u>	<u>\$ 30,632</u>

The Company classifies its short-term investments as "available-for-sale" as they are intended to be available for use in current operations.

NOTE 7—COMMITMENTS AND CONTINGENCIES

Indemnification obligations

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold and certain intellectual property rights. In each of these circumstances, the Company's indemnification obligations are conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claims. Further, the Company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements.

It is not possible to predict the maximum potential amount of future payments that may be required under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on its business, financial condition, cash flows or results of operations.

Product warranties

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs were not material for the three months or nine months ended December 31, 2016 or 2015.

NOTE 8—STOCK-BASED COMPENSATION

The Company granted options under the 2007 Equity Incentive Plan (the "2007 Plan") until August 2016 when it was terminated as to future awards, although it continues to govern the terms of options that remain outstanding under the 2007 Plan. In connection with the stockholders' approval of the 2016 Equity Incentive Plan (the "2016 Plan"), 6,000,000 shares available for future award under the 2007 Plan were transferred to the 2016 Plan, 705,699 shares available for grant under the 2007 plan were canceled and the 2007 Plan was terminated. Shares subject to options under the 2007 Plan that expire or are forfeited for any reason after the date of the 2007 Plan's termination will become available for grant under the 2016 Plan.

The 2016 Plan was approved by the Company's board of directors in June 2016 and was subsequently approved by the Company's stockholders in August 2016. The 2016 Plan provides for issuance of a variety of stock-based compensation awards, including stock options, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units, other stock-based awards and cash-based awards. The exercise price of each stock-based award issued under the 2016 Plan is required to be no less than the fair value of the Company's common stock, as determined by the board of directors on the date of the grant.

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As of December 31, 2016, 5,701,795 shares of common stock were available for grant under the 2016 Plan.

The following table summarizes the Company's stock option activities for the nine months ended December 31, 2016:

	Shares Available for Grant	Number of Shares Underlying Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Intrinsic Value
Balance at March 31, 2016	6,432,063	7,625,705		\$ 5.08	
Options reserved	1,085,818	—		—	
Terminated plan	(705,699)	—		—	
Granted	(1,125,188)	1,125,188		\$ 4.92	
Exercised	—	(138,683)		\$ 3.63	\$ 181,058
Forfeited	14,801	(962,634)		\$ 5.54	
Balance at December 31, 2016	<u>5,701,795</u>	<u>7,649,576</u>		\$ 5.02	
Options vested and exercisable		<u>4,714,337</u>	4.05	\$ 4.98	<u>\$6,623,354</u>
Options vested and expected to vest		<u>7,595,022</u>	5.74	\$ 5.02	<u>\$9,967,662</u>

The weighted average fair value per underlying share of options granted during the three months ended December 31, 2016 and 2015 was \$1.75 and \$1.48, respectively, and for the nine months ended December 31, 2016 and 2015 was \$1.56 and \$1.70, respectively.

Options outstanding by exercise price at December 31, 2016 were as follows:

Exercise Price	Number of Shares Underlying Options Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Vested and Exercisable	Weighted Average Exercise Price
\$ 2.43 - 3.40	849,904	\$ 3.17	4.44	618,296	\$ 3.09
\$ 3.43 - 4.00	1,216,534	\$ 3.80	3.25	1,055,944	\$ 3.83
\$ 4.17 - 4.81	910,620	\$ 4.41	4.98	820,370	\$ 4.40
\$ 4.90 - 4.98	777,463	\$ 4.95	7.25	310,603	\$ 4.91
\$ 4.99 - 5.23	1,241,316	\$ 5.09	8.70	99,960	\$ 5.19
\$ 5.28 - 5.76	819,305	\$ 5.55	7.42	311,727	\$ 5.62
\$ 6.00 - 6.54	863,008	\$ 6.32	4.83	798,008	\$ 6.32
\$ 6.61 - 6.86	651,853	\$ 6.77	6.06	379,856	\$ 6.74
\$ 7.00	206,193	\$ 7.00	3.59	206,193	\$ 7.00
\$ 9.20	113,380	\$ 9.20	4.08	113,380	\$ 9.20
	<u>7,649,576</u>	\$ 5.02	5.77	<u>4,714,337</u>	\$ 4.98

The following table summarizes stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations, all relating to employee stock plans:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands)			
Cost of revenues	\$ 78	\$ 85	\$ 209	\$ 242
Research and development	251	208	712	649
Selling, general and administrative	100	121	438	496
Total	<u>\$ 429</u>	<u>\$ 414</u>	<u>\$ 1,359</u>	<u>\$ 1,387</u>

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures in accordance with

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authoritative guidance. The Company estimates forfeitures at the time of grant and revises the original estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

No tax benefit related to stock-based compensation was recognized in the three months or nine months ended December 31, 2016 or December 31, 2015 due to a full valuation allowance. There were no windfall tax benefits realized from exercised stock options in any of these periods. Compensation cost capitalized within inventory at December 31, 2016 was immaterial. As of December 31, 2016, the Company's total unrecognized compensation cost was \$3.4 million, which will be recognized over a weighted average period of 2.23 years. The Company calculated the fair value of stock-based awards in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands)		(In thousands)	
Stock Option Plans:				
Risk-free interest rate	1.62 %	1.56 %	1.12 - 1.62 %	1.52 - 1.57 %
Expected life (in years)	5.00	5.00	5.00	5.00
Volatility	33.3 %	36.3 %	33.3 - 34.8 %	36.3 - 38.0 %
Dividend yield	— %	— %	— %	— %
Employee Stock Purchase Plan:				
Risk-free interest rate	0.45 %	0.15 %	0.38 - 0.45 %	0.09 - 0.15 %
Expected life (in years)	0.50	0.50	0.50	0.50
Volatility	30.8 %	27.9 %	30.8 - 39.6 %	26.3 - 27.9 %
Dividend yield	— %	— %	— %	— %

NOTE 9—SEGMENT AND GEOGRAPHIC INFORMATION

Based on its operating management and financial reporting structure, the Company has determined that it has one reportable business segment: the design, development and sale of integrated circuits.

The following is a summary of net revenues by geographic area based on the location to which product is shipped:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
	(In thousands)			
United States	\$ 3,838	\$ 4,873	\$ 14,094	\$ 16,123
China	2,024	2,808	8,121	9,916
Singapore	2,947	1,682	8,502	4,681
Netherlands	1,576	2,518	3,539	6,073
Rest of the world	1,099	1,040	3,532	3,730
	\$ 11,484	\$ 12,921	\$ 37,788	\$ 40,523

All sales are denominated in United States dollars.

NOTE 10—ACQUISITION

On November 23, 2015, the Company acquired all of the outstanding capital stock of privately held MikaMonu Group Ltd. ("MikaMonu"), a development-stage, Israel-based company that specializes in in-place associative computing for markets including big data, computer vision and cyber security. MikaMonu, located in Tel Aviv, held 12 United States patents and a number of pending patent applications.

The acquisition was accounted for as a purchase under authoritative guidance for business combinations. The purchase price of the acquisition was allocated to the intangible assets acquired, with the excess

of the purchase price over the fair value of assets acquired recorded as goodwill. The Company will perform a goodwill impairment test in February of each fiscal year.

The results of operations of MikaMonu and the estimated fair value of the assets acquired were included in the Company's condensed consolidated financial statements beginning November 23, 2015.

Consideration

Under the terms of the acquisition agreement, the Company paid the former MikaMonu shareholders initial cash consideration of approximately \$4.4 million at the closing on November 23, 2015. In addition, \$484,000 was deposited in escrow to provide a fund for potential future indemnification claims by the Company. This amount is included in prepaid expenses and other current assets on the Condensed Consolidated Balance Sheet at December 31, 2016.

The Company is also required to pay the former MikaMonu shareholders future contingent consideration consisting of retention payments and "earnout" payments, as described below.

The Company will make cash retention payments of up to an additional \$2.5 million to the three former MikaMonu shareholders in installments over a four-year period, conditioned on the continued employment of Dr. Avidan Akerib, MikaMonu's co-founder and chief technologist. The retention amount of \$2.5 million has been deposited in escrow. Of this amount, \$750,000 is included in prepaid expenses and other current assets and the remaining \$1,750,000 is included in other assets on the Condensed Consolidated Balance Sheet at December 31, 2016.

The Company will also make "earnout" payments to the former MikaMonu shareholders in cash or shares of the Company's common stock, at the Company's discretion, during a period of up to ten years following the closing if certain product development milestones and revenue targets for products based on the MikaMonu technology are achieved. Earnout amounts of \$750,000 will be payable if certain product development milestones are achieved by December 31, 2017. Additional earnout amounts of \$2,750,000 and \$4,000,000 will be payable if certain revenue milestones are achieved by January 1, 2021 and January 1, 2022, respectively; and additional payments, up to a maximum of \$30 million, equal to 5% of net revenues from the sale of qualifying products in excess of certain thresholds, will be made quarterly through December 31, 2025.

The portion of the retention payment contingently payable to Dr. Akerib (approximately \$1.2 million) will be recorded as compensation expense over the period that his services are provided to the Company. The portion of the retention payment contingently payable to the other former MikaMonu shareholders (approximately \$1.3 million) plus the maximum amount of the potential earnout payments totals approximately \$38.8 million. The Company determined that the fair value of this contingent consideration liability was \$5.8 million at the acquisition date. This contingent consideration liability is included in other accrued expenses on the Condensed Consolidated Balance Sheet at March 31, 2016 in the amount of \$5.9 million. The contingent consideration liability is included in other accrued expenses on the Condensed Consolidated Balance Sheet at December 31, 2016 in the amount of \$4.9 million and \$1.1 million is included in accrued expenses and other liabilities.

The fair value of the contingent consideration liability was initially determined as of the acquisition date using unobservable inputs. These inputs include the estimated amount and timing of future cash flows, the probability of success (achievement of the various contingent events) and a risk-adjusted discount rate of approximately 14.8% used to adjust the probability-weighted cash flows to their present value. Subsequent to the acquisition date, at each reporting period, the contingent consideration liability is recorded at its fair value with changes reflected in the Consolidated Statements of Operations. The change in fair value for the quarter and nine months ended December 31, 2016 was \$41,000 and \$121,000, respectively.

Purchase price allocation

The allocation of the purchase price to acquired identifiable intangible assets and goodwill was based on their estimated fair values at the date of acquisition. The fair value allocated to patents was \$3.5 million and the fair value allocated to goodwill was \$8.0 million.

The fair value allocated to tangible and identifiable intangible assets and goodwill of MikaMonu acquired on November 23, 2015 was computed as follows (in thousands):

Cash and cash equivalents	\$ 1
Other receivables	54
Property and equipment, net	10
Intangible assets	3,500
Goodwill	8,030
Total assets acquired	11,595
Accrued expenses	(10)
Net deferred tax liability	(821)
Total liabilities assumed	(831)
Fair value of net assets acquired	\$ 10,764

The deferred tax liability associated with the estimated fair value adjustments of the intangible assets acquired was recorded at an estimated weighted average statutory tax rate in the jurisdictions where the fair value adjustments may occur.

Identifiable intangible assets

The following table sets forth the components of the identifiable intangible assets acquired in the MikaMonu acquisition, which are being amortized over their estimated useful lives on a straight-line basis:

	<u>Fair Value</u>	<u>Useful Life</u>
	<u>(in thousands)</u>	<u>(in years)</u>
Patents	\$ 3,500	15
Total acquired identifiable intangible assets	\$ 3,500	

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q, and in particular the following Management's Discussion and Analysis of Financial Condition and Results of Operations, includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as "anticipates," "believes," "expects," "intends," "may," "will," and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under "Risk Factors," those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission ("SEC"). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

Overview

We are a fabless semiconductor company that designs, develops and markets static random access memories, or SRAMs, that operate at speeds of less than 10 nanoseconds, which we refer to as Very Fast SRAMs, and low latency dynamic random access memories, or LDRAMs, primarily for the networking and telecommunications markets. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Our revenues have been substantially impacted by significant fluctuations in sales to Cisco Systems, historically our largest customer, and more recently to Nokia (Alcatel-Lucent). We expect that future direct and indirect sales to these two customers will continue to fluctuate significantly on a quarterly basis. The worldwide financial crisis and the resulting economic impact on the end markets we serve have adversely impacted our financial results since the second half of fiscal 2009, and we expect that the unsettled global economic environment will continue to affect our operating results in future periods. However, with no debt, substantial liquidity and a history of positive cash flows from operations, we believe we are in a better financial position than many other companies of our size.

Revenues. Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications OEMs accounted for 63% to 73% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for defense applications such as radar and guidance systems, for professional audio applications such as sound mixing systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

As is typical in the semiconductor industry, the selling prices of our products generally decline over the life of the product. Our ability to increase net revenues, therefore, is dependent upon our ability to increase unit sales volumes of existing products and to introduce and sell new products with higher average selling prices in quantities sufficient to compensate for the anticipated declines in selling prices of our more mature products. Although we expect the average selling prices of individual products to decline over time, we believe that, over the next several quarters, our overall average selling prices will increase due to a continuing shift in product mix to a higher percentage of higher price, higher density products. Our ability to increase unit sales volumes is dependent primarily upon increases in customer demand but, particularly in periods of increasing demand, can also be affected by our ability to increase production through the availability of increased wafer fabrication capacity from Taiwan Semiconductor Manufacturing Company, or TSMC, and Powerchip, our wafer suppliers, and our ability to increase the number of good integrated circuit die produced from each wafer through die size reductions and yield enhancement activities.

We may experience fluctuations in quarterly net revenues for a number of reasons. Historically, orders on hand at the beginning of each quarter are insufficient to meet our revenue objectives for that quarter and are generally cancelable up to 30 days prior to scheduled delivery. Accordingly, we depend on obtaining and shipping

orders in the same quarter to achieve our revenue objectives. In addition, the timing of product releases, purchase orders and product availability could result in significant product shipments at the end of a quarter. Failure to ship these products by the end of the quarter may adversely affect our operating results. Furthermore, our customers may delay scheduled delivery dates and/or cancel orders within specified timeframes without significant penalty.

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Revenues from product sales, except for sales to distributors, are generally recognized upon shipment, net of sales returns and allowances. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to distributors are recorded as deferred revenues for financial reporting purposes and recognized as revenues when the products are resold by the distributors to the OEM. Sales to distributors are made under agreements allowing for returns or credits under certain circumstances. We therefore defer recognition of revenue on sales to distributors until products are resold by the distributor.

Nokia (Alcatel-Lucent) was our largest customer in fiscal 2016 and 2015. Nokia (Alcatel-Lucent) purchases products directly from us and through contract manufacturers and distributors. Purchases by Nokia (Alcatel-Lucent) represented approximately 42%, 32%, 25% and 19% of our net revenues in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, respectively. Cisco Systems, historically our largest OEM customer, purchases our products primarily through its consignment warehouse, Wintec Industries Inc, and also purchases some products through its contract manufacturers and directly from us. Based on information provided to us by Cisco Systems' consignment warehouses and contract manufacturers, purchases by Cisco Systems represented approximately 9%, 9%, 13% and 19% of our net revenues in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, respectively. Our revenues have been substantially impacted by significant fluctuations in sales to Nokia (Alcatel-Lucent) and Cisco Systems, and we expect that future direct and indirect sales to these two customers will continue to fluctuate substantially on a quarterly basis and that such fluctuations may significantly affect our operating results in future periods. To our knowledge, none of our other OEM customers accounted for more than 10% of our net revenues in the nine months ended December 31, 2016 or in fiscal 2016, 2015 or 2014.

Cost of Revenues. Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and a significant portion of our wafer sort testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to TSMC, Powerchip and independent assembly and test houses. Because we do not have long-term, fixed-price supply contracts, our wafer fabrication and other outsourced manufacturing costs are subject to the cyclical fluctuations in demand for semiconductors. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Sunnyvale, California and our branch operations in Taiwan.

Gross Profit. Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products. We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes, stock-based compensation and fees paid to consultants. We charge all research and development expenses to operations as incurred. We charge mask costs used in production to cost of revenues over a 12-month period. However, we charge costs related to pre-production mask sets, which are not used in production, to research and development expenses at the time they are incurred. These charges often arise as we transition to new process technologies and, accordingly, can cause research and development expenses to fluctuate on a quarterly basis. We believe that continued investment in research and development is critical to our long-term success, and we expect to continue to devote significant resources to product development activities. In particular, we are devoting substantial resources to the development of a new category of in-place associative computing products based on patented technology obtained in our acquisition of MikaMonu in November 2015. Accordingly, we expect that our research and development

expenses will continue to be substantial in future periods and may lead to operating losses in some periods. Such expenses as a percentage of net revenues may fluctuate from period to period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future periods if we are able to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of any future growth that we are able to achieve, general and administrative expenses will generally increase in absolute dollars. General and administrative expenses increased significantly beginning in fiscal 2012 as a result of substantial legal expenses, principally related to our patent infringement and antitrust litigation with Cypress Semiconductor Corporation. These expenses varied significantly from quarter to quarter thereafter, depending on the relative level of activity in the Cypress litigation. In May 2015, we entered into a settlement agreement to resolve our protracted litigation with Cypress. Although we ceased to incur significant legal expenses related to our litigation with Cypress after the quarter ended June 30, 2015, legal expenses associated with unrelated commercial and trade secret litigation in which we were the plaintiff continued to be substantial through the quarter ended December 31, 2015, reflecting preparation for and conduct of the trial of that case which concluded in November 2015.

Results of Operations

The following table sets forth statement of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Net revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	43.4	50.6	45.6	49.2
Gross profit	56.6	49.4	54.4	50.8
Operating expenses:				
Research and development	33.2	21.5	30.7	21.5
Selling, general and administrative	21.3	40.0	21.1	36.4
Total operating expenses	54.5	61.5	51.8	57.9
Income (loss) from operations	2.1	(12.1)	2.6	(7.1)
Interest and other income (expense), net	0.5	0.7	0.8	0.5
Income (loss) before income taxes	2.6	(11.4)	3.4	(6.6)
Provision for income taxes	(0.5)	(5.0)	0.2	(1.5)
Net income (loss)	3.1	(6.4)	3.2	(5.1)

Net Revenues. Net revenues decreased by 11.1% from \$12.9 million in the three months ended December 31, 2015 to \$11.5 million in the three months ended December 31, 2016 and by 6.7% from \$40.5 million in the nine months ended December 31, 2015 to \$37.8 million in the nine months ended December 31, 2016. Direct and indirect sales to Nokia (Alcatel-Lucent), currently our largest customer, decreased from \$4.8 million in the three months ended December 31, 2015 to \$4.5 million in the three months ended December 31, 2016 and increased from \$12.8 million in the nine months ended December 31, 2015 to \$15.7 million in the nine months ended December 31, 2016, reflecting increased demand for its systems that incorporate our products. The decrease in the December 31, 2016 quarter reflected an inventory correction to reduce inventory levels to align them with production requirements. Direct and indirect sales to Cisco Systems, historically our largest customer, were unchanged at \$1.1 million in the three months ended December 31, 2015 and December 31, 2016 and increased from \$3.5 million in the nine months ended December 31, 2015 to \$3.6 million in the nine months ended December 31, 2016. Net revenues from sales to customers in China declined by \$800,000 from \$2.8 million in the three months ended December 31, 2015 to \$2.0 million in the three months ended December 31, 2016 and by \$1.8 million from \$9.9 million in the nine months ended December 31, 2015 to \$8.1 million in the nine months ended December 31, 2016, reflecting the continuing weakness in the global networking and telecommunications markets and, in particular, continued weakness in Asia.

We believe that our net revenues during the nine months ended December 31, 2015 were also negatively impacted by uncertainty regarding the outcome of our patent litigation with Cypress Semiconductor that was settled in May 2015. We believe that this market uncertainty was resolved with the settlement of the litigation. However, some design-in losses that we suffered during the pendency of the lawsuit and a related ITC proceeding will continue to adversely affect our revenues throughout the life of the related products. Shipments of our SigmaQuad product line accounted for 55.8% of total shipments in the nine months ended December 31, 2016 compared to 53.6% of total shipments in the nine months ended December 31, 2015.

Cost of Revenues. Cost of revenues decreased by 23.7% from \$6.5 million in the three months ended December 31, 2015 to \$5.0 million in the three months ended December 31, 2016 and by 13.5% from \$19.9 million in the nine months ended December 31, 2015 to \$17.2 million in the nine months ended December 31, 2016. Cost of revenues decreased primarily due to improved gross margin and the decrease in net revenues discussed above. Cost of revenues included stock-based compensation expense of \$78,000 and \$85,000, respectively, for the three months ended December 31, 2016 and 2015 and \$209,000 and \$242,000, respectively, for the nine months ended December 31, 2016 and 2015.

Gross Profit. Gross profit increased by 1.7% from \$6.4 million in the three months ended December 31, 2015 to \$6.5 million in the three months ended December 31, 2016 and was unchanged at \$20.6 million in the nine months ended December 31, 2015 and December 31, 2016. Gross margin increased from 49.4% in the three months ended December 31, 2015 to 56.6% in the three months ended December 31, 2016 and from 50.8% in the nine months ended December 31, 2015 to 54.4% in the nine months ended December 31, 2016. The increase in gross profit in the three months ended December 31, 2016 and improvements in gross margin in both periods were primarily related to favorable changes in the mix of products and customers.

Research and Development Expenses. Research and development expenses increased by 37.1% from \$2.8 million in the three months ended December 31, 2015 to \$3.8 million in the three months ended December 31, 2016. This increase was primarily due to an increase of \$728,000 in payroll related expenses and lesser increases in patent related legal expenses, software maintenance expenses and rent expense, primarily related to our associative processor development activities. Research and development expenses included stock-based compensation expense of \$251,000 and \$208,000, respectively, for the three months ended December 31, 2016 and 2015. Research and development expenses increased 33.0% from \$8.7 million in the nine months ended December 31, 2015 to \$11.6 million in the nine months ended December 31, 2016. This increase was primarily due to an increase of \$1.8 million in payroll related expenses and \$564,000 for purchased IP both primarily related to our associative processor development activities. Research and development expenses included stock-based compensation expense of \$712,000 and \$649,000, respectively, for the nine months ended December 31, 2016 and 2015.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased by 52.6% from \$5.2 million in the three months ended December 31, 2015 to \$2.4 million in the three months ended December 31, 2016. This decrease was primarily related to a decrease in legal expenses of \$2.7 million incurred primarily in connection with a commercial and trade secret lawsuit against United Memories, Inc. ("UMI") and Integrated Silicon Solutions, Inc. ("ISSI"), the trial of which concluded in November 2015. Selling, general and administrative expenses included stock-based compensation expense of \$100,000 and \$121,000, respectively, for the three months ended December 31, 2016 and 2015. Selling, general and administrative expenses decreased 46.0% from \$14.7 million in the nine months ended December 31, 2015 to \$8.0 million in the nine months ended December 31, 2016. This decrease was primarily related to a decrease in legal expenses of \$6.7 million related to the resolution of patent infringement and antitrust litigation involving Cypress Semiconductor Corporation which was settled in May 2015, partially offset by increased expenses related to the UMI/ISSI litigation. Selling, general and administrative expenses included stock-based compensation expense of \$438,000 and \$496,000, respectively, for the nine months ended December 31, 2016 and 2015.

Interest and Other Income (Expense), Net. Interest and other income (expense), net decreased by 31.5% from income of \$89,000 in the three months ended December 31, 2015 to \$61,000 in the three months ended December 31, 2016. Interest income decreased by \$3,000 due to lower interest rates received on our cash and short-term and long-term investments and a lesser total cash and investments balance. A foreign exchange gain of \$11,000 for the three months ended December 31, 2015 compared to an exchange loss of \$20,000 for the three months ended December 31, 2016. Interest and other income (expense), net increased 60.3% from income of \$184,000 in the nine

months ended December 31, 2015 to \$295,000 in the nine months ended December 31, 2016. Interest income decreased by \$2,000 due to lower interest rates received on our cash and short-term and long-term investments on a lesser total cash and investments balance. A foreign exchange loss of \$45,000 for the nine months ended December 31, 2015 compared to income of \$68,000 for the nine months ended December 31, 2016. The exchange gains and losses in each period were related to our Taiwan branch operations and in the three months and nine month ended December 31, 2016 and three months ended December 31, 2015 also included our operations in Israel.

Provision (benefit) for Income Taxes. The benefit for income taxes decreased from \$652,000 in the three months ended December 31, 2015 to \$53,000 in the three months ended December 31, 2016 and decreased from a benefit of \$598,000 in the nine months ended December 31, 2015 to a provision of \$64,000 in the nine months ended December 31, 2016. These changes were due to fluctuations in the relative mix of income among our operating jurisdictions.

Net Income (Loss). The net loss of \$819,000 in the three months ended December 31, 2015 compares to net income of \$348,000 in the three months ended December 31, 2016. The net loss of \$2.1 million in the nine months ended December 31, 2015 compares to net income of \$1.2 million in the nine months ended December 31, 2016. These fluctuations were primarily due to the changes in net revenues, gross profit and operating expenses discussed above.

Liquidity and Capital Resources

As of December 31, 2016, our principal sources of liquidity were cash, cash equivalents and short-term investments of \$47.0 million compared to \$55.1 million as of March 31, 2016.

Net cash provided by operating activities was \$1.3 million for the nine months ended December 31, 2016 compared to net cash used in operating activities of \$3.2 million for the nine months ended December 31, 2015. The primary sources of cash in the current nine month period were net income of \$1.2 million, stock-based compensation of \$1.4 million and depreciation and amortization expenses of \$1.2 million. The primary use of cash in the nine months ended December 31, 2016 was an increase in inventory of \$2.6 million. Our inventory balance has primarily increased due to assembling our LLD RAM products to support shipments in the next six to nine months as we qualify a new assembly vendor.

Net cash provided by investing activities was \$3.3 million in the nine months ended December 31, 2016 compared to \$365,000 in the nine months ended December 31, 2015. Investment activities in the nine months ended December 31, 2016 consisted primarily of the maturity of corporate notes, state and municipal obligations and certificates of deposit of \$17.6 million, partially offset by the purchase of agency bonds and certificates of deposit of \$14.1 million and the purchase of property and equipment for \$194,000. Investment activities in the nine months ended December 31, 2015 consisted primarily of the maturity of corporate notes, state and municipal obligations and certificates of deposit of \$21.3 million, partially offset by the purchase of investments of \$12.5 million, \$4.4 million in cash representing a portion of the consideration for our acquisition of MikaMonu, restricted cash of \$3.0 million representing amounts held in escrow related to the acquisition and the purchase of property and equipment for \$1.1 million.

Net cash used in financing activities in the nine months ended December 31, 2016 primarily consisted of the repurchase of \$7.1 million of our common stock at an average purchase price of \$4.33 per share, partially offset by the net proceeds from the sale of common stock pursuant to our employee stock plans. Net cash used by financing activities in the nine months ended December 31, 2015 primarily consisted of the repurchase of \$4.1 million of our common stock at an average purchase price of \$4.99 per share, partially offset by the net proceeds from the sale of common stock pursuant to our employee stock plans.

We believe that our existing balances of cash, cash equivalents and short-term investments, and cash flow expected to be generated from our future operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including revenue growth, if any, that we experience, the extent to which we utilize subcontractors, the levels of inventory and accounts

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receivable that we maintain, the timing and extent of spending to support our product development efforts and the expansion of our sales and marketing. Additional capital may also be required for the consummation of any acquisition of businesses, products or technologies that we may undertake. We cannot assure that additional equity or debt financing, if required, will be available on terms that are acceptable or at all.

Contractual Obligations

The following table describes our contractual obligations as of December 31, 2016:

	Payments due by period				Total
	Up to 1 year	1 - 3 years	3 - 5 years	More than 5 years	
Facilities and equipment leases	\$ 300,000	\$ 319,000	\$ 159,000	\$ 62,000	\$ 840,000
Wafer, test and mask purchase obligations	1,589,000	934,000	—	—	2,523,000
	<u>\$1,889,000</u>	<u>\$1,253,000</u>	<u>\$ 159,000</u>	<u>\$ 62,000</u>	<u>\$3,363,000</u>

As of December 31, 2016, the current portion of our unrecognized tax benefits was \$0, and the long-term portion was \$242,000. We do not expect to make federal income tax payments in the next twelve months, and we are not able to make a reasonably reliable estimate of the timing of such payments due to uncertainties in the timing of tax credit outcomes.

In connection with the acquisition of MikaMonu on November 23, 2015, we are required to make contingent consideration payments to the former MikaMonu shareholders conditioned upon the retention of MikaMonu's key employee and the achievement of certain product development milestones and revenue targets for products based on the MikaMonu technology. As of December 31, 2016, the accrual for potential contingent consideration was \$6.0 million.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

Off-Balance Sheet Arrangements

At December 31, 2016, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to the type of financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

In November 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-18, "*Statement of Cash Flows (Topic 230): Restricted Cash*". ASU 2016-18 requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the impact this new guidance will have on our consolidated statement of cash flows

In October 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-16, "*Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*." ASU 2016-16 requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs and eliminates the exception for an intra-entity transfer of an asset other than inventory. This ASU is

effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods, and is required to be adopted using a modified retrospective approach, with early adoption permitted. We are evaluating the impact of the adoption of this ASU on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*". ASU 2016-15 adds or clarifies guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. The amendments in the update provide guidance on eight specific cash flow issues, and is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The amendments to the guidance should be applied using a retrospective transition method for each period presented and if it is impracticable to apply all of the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. We are currently evaluating the impact this new guidance will have on our consolidated statement of cash flows.

In June 2016, the FASB issued ASU 2016-13, "*Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*," ASU 2016-13 replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, we will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The new standard will be effective for us beginning April 1, 2020, with early adoption permitted beginning April 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "*Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This accounting standard update will be effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, and early adoption is permitted. We are currently evaluating the methods and impact of adopting the new accounting standard on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "*Leases (Topic 842)*." The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, "*Elements of Financial Statements*," and, therefore, recognition of those lease assets and lease liabilities represents a change of previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. This ASU is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Although we are currently evaluating the impact the pronouncement will have on our consolidated financial statements and related disclosures, we expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In January 2016, the FASB issued ASU 2016-01, "*Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*." ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. This accounting standard update will be effective for fiscal years beginning after December 15, 2017,

including interim periods within those fiscal years, and early adoption is permitted. We are currently evaluating the impact of this accounting standard update on our consolidated financial statements.

In September 2015, the FASB issued a new accounting standard that eliminates the requirement to restate prior period financial statements for measurement period adjustments following a business combination. The new guidance requires that the cumulative impact of a measurement period adjustment including the impact on prior periods be recognized in the reporting period in which the adjustment is identified along with additional disclosures. The new guidance was effective for us beginning in the first quarter of fiscal 2017. Implementation of this new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, "*Simplifying the Measurement of Inventory*." This standard update intends to simplify the subsequent measurement of inventory, excluding inventory accounted for under the last-in, first-out or the retail inventory methods. The update replaces the current lower of cost or market test with a lower of cost and net realizable value test. Under the current guidance, market could be replacement cost, net realizable value or net realizable value less an approximately normal profit margin. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The update is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of this accounting standard on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "*Presentation of Financial Statements - Going Concern*." The amendment requires that our management evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about our ability to continue as a going concern within one year after the date that the financial statements are issued. If conditions or events raise substantial doubt about our ability to continue as a going concern additional disclosure is required to enable users of the financial statements to understand the conditions or events, our evaluation of the significance of those conditions and our plans that are intended to alleviate or our plans that have alleviated substantial doubt. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "*Revenue from Contracts with Customers*." The new accounting standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The accounting standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. Early adoption is permitted for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. ASU No. 2014-09 provides for one of two methods of transition: retrospective application to each prior period presented; or recognition of the cumulative effect of retrospective application of the new standard in the period of initial application. We are currently evaluating the full impact of this new guidance on our consolidated financial statements, including selection of the transition method. However, assuming all other revenue recognition criteria have been met, it is likely that the new guidance would require us to recognize revenue and cost relating to distributor sales upon product delivery, subject to estimated allowance for distributor price adjustments and rights of return. In March, April and May 2016, the FASB issued additional updates to the new revenue standard relating to reporting revenue on a gross versus net basis, identifying performance obligations and licensing arrangements, and narrow-scope improvements and practical expedients, respectively. We are in the process of assessing the impact this additional guidance is expected to have upon adoption, including determining the adoption method.

Item 3. *Quantitative and Qualitative Disclosure About Market Risk*

Foreign Currency Exchange Risk. Our revenues and expenses, except those expenses related to our operations in Taiwan and in Israel, including subcontractor manufacturing expenses, are denominated in U.S. dollars. As a result, we have relatively little exposure for currency exchange risks, and foreign exchange gains and losses have been minimal to date. We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes.

In the future, if we feel our foreign currency exposure has increased, we may consider entering into hedging transactions to help mitigate that risk.

Interest Rate Sensitivity. We had cash, cash equivalents, short-term investments and long-term investments totaling \$61.1 million at December 31, 2016. These amounts were invested primarily in money market funds, state and municipal obligations, corporate notes, certificates of deposit, government agency bonds and foreign government obligations. The cash, cash equivalents and short-term marketable securities are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. We believe a hypothetical 100 basis point increase or decrease in interest rates would not materially affect the fair value of our interest-sensitive financial instruments. Declines in interest rates, however, will reduce future investment income.

Item 4. *Controls and Procedures*

Management’s Evaluation of Disclosure Controls and Procedures

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of December 31, 2016, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report for the purpose of ensuring that the information required to be disclosed by us in this report is made known to them by others on a timely basis, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in order to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported by us within the time periods specified in the SEC’s rules and instructions for Form 10-Q.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 1A. *Risk Factors*

Our future performance is subject to a variety of risks. If any of the following risks actually occur, our business, financial condition and results of operations could suffer and the trading price of our common stock could decline. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations. You should also refer to other information contained in this report, including our condensed consolidated financial statements and related notes. The risk factors described below do not contain any material changes from those previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

Unpredictable fluctuations in our operating results could cause our stock price to decline.

Our quarterly and annual revenues, expenses and operating results have varied significantly and are likely to vary in the future. For example, in the eleven fiscal quarters ended December 31, 2016, we recorded net revenues of as much as \$14.2 million and as little as \$11.5 million and quarterly operating income of as much as \$389,000 and, in eight quarters, operating losses, including our operating loss of \$2.9 million in the quarter ended March 31, 2015. We therefore believe that period-to-period comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future performance or the future performance of our stock price. In future periods, we may not have any revenue growth, or our revenues could decline. Furthermore, if our operating expenses exceed our expectations, our financial performance could be adversely affected. Factors that may affect periodic operating results in the future include:

- our ability to anticipate and conform to new industry standards.
- unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long-term contract;
- changes in our customers' inventory management practices;
- fluctuations in availability and costs associated with materials needed to satisfy customer requirements;
- manufacturing defects, which could cause us to incur significant warranty, support and repair costs, lose potential sales, harm our relationships with customers and result in write-downs;
- changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors;
- our ability to address technology issues as they arise, improve our products' functionality and expand our product offerings.

Our expenses are, to a large extent, fixed, and we expect that these expenses will increase in the future. We will not be able to adjust our spending quickly if our revenues fall short of our expectations. If this were to occur, our operating results would be harmed. If our operating results in future quarters fall below the expectations of market analysts and investors, the price of our common stock could fall.

Our two largest OEM customers account for a significant percentage of our net revenues. If either of these customers, or any of our other major customers, reduces the amount they purchase or stop purchasing our products, our operating results will suffer.

Nokia (Alcatel-Lucent), currently our largest customer, purchases our products directly from us and through contract manufacturers and distributors. Purchases by Nokia (Alcatel-Lucent) represented approximately 42%, 32%, 25% and 19% of our net revenues in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, respectively. Cisco Systems, historically our largest OEM customer, purchases our products through its consignment warehouses and contract manufacturers and directly from us. Purchases by Cisco Systems represented approximately 9%, 9%, 13% and 19% of our net revenues in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, respectively. We expect that our operating results in any given period will continue to depend significantly on orders from our key OEM customers, particularly Nokia (Alcatel-Lucent) and Cisco Systems, and our future success is dependent to a large degree on the business success of these OEMs over which we have no control. We do not have long-term contracts with Nokia (Alcatel-Lucent), Cisco Systems or any of our other major OEM customers, distributors or contract manufacturers that obligate them to purchase our products. We expect that future direct and indirect sales to Nokia (Alcatel-Lucent), Cisco Systems and our other key OEM customers will continue to fluctuate significantly on a quarterly basis and that such fluctuations may substantially affect our operating results in future periods. If we fail to continue to sell to our key OEM customers, distributors or contract manufacturers in sufficient quantities, our business could be harmed.

We have incurred significant losses in prior periods and may incur losses in the future.

We have incurred significant losses in prior periods. We incurred losses of \$2.2 million and \$5.0 million during fiscal 2016 and 2015, respectively. Our operating expenses over the past several years included substantial expenses related to legal proceedings which resulted in operating losses. Although these proceedings are substantially concluded, there can be no assurance that our Very Fast SRAMs will continue to receive broad market acceptance, that our new product development initiatives will be successful or that we will be able to achieve sustained revenue growth or profitability.

We depend upon the sale of our Very Fast SRAMs for most of our revenues, and a downturn in demand for these products could significantly reduce our revenues and harm our business.

We derive most of our revenues from the sale of Very Fast SRAMs, and we expect that sales of these products will represent the substantial majority of our revenues for the foreseeable future. Our business depends in large part upon continued demand for our products in the markets we currently serve, and adoption of our products in new markets. Market adoption will be dependent upon our ability to increase customer awareness of the benefits of our products and to prove their high-performance and cost-effectiveness. We may not be able to sustain or increase our revenues from sales of our products, particularly if the networking and telecommunications markets were to experience another significant downturn in the future. Any decrease in revenues from sales of our products could harm our business more than it would if we offered a more diversified line of products.

If we do not successfully develop new products to respond to rapid market changes due to changing technology and evolving industry standards, particularly in the networking and telecommunications markets, our business will be harmed. Our effort to develop new in-place associative computing products involves significant additional risks.

If we fail to offer technologically advanced products and respond to technological advances and emerging standards, we may not generate sufficient revenues to offset our development costs and other expenses, which will hurt our business. The development of new or enhanced products is a complex and uncertain process that requires the accurate anticipation of technological and market trends. In particular, the networking and telecommunications markets are rapidly evolving and new standards are emerging. We are vulnerable to advances in technology by competitors, including new SRAM architectures, new forms of DRAM and the emergence of new memory technologies that could enable the development of products that feature higher performance or lower cost. We may experience development, marketing and other technological difficulties that may delay or limit our ability to respond to technological changes, evolving industry standards, competitive developments or end-user requirements. For example, because we have limited experience developing integrated circuits, or IC, products other than Very Fast SRAMs and LLDRAMs, our efforts to introduce new products may not be successful and our business may suffer. Other challenges that we face include:

- our products may become obsolete upon the introduction of alternative technologies;
- we may incur substantial costs if we need to modify our products to respond to these alternative technologies;
- we may not have sufficient resources to develop or acquire new technologies or to introduce new products capable of competing with future technologies;
- new products that we develop may not successfully integrate with our end-users' products into which they are incorporated;
- we may be unable to develop new products that incorporate emerging industry standards;
- we may be unable to develop or acquire the rights to use the intellectual property necessary to implement new technologies; and

- when introducing new or enhanced products, we may be unable to manage effectively the transition from older products.

In particular, we are devoting substantial efforts and resources to the development of in-place associative computing solutions utilizing patented technology obtained in our 2015 acquisition of MikaMonu. This ongoing development project involves the commercialization of new, cutting-edge technology, will require a substantial effort over more than a year and will be subject to significant risks, including technical problems, delays or unanticipated costs that may be encountered in the development of the new associative computing products and risks associated with the establishment of new markets and customer relationships for the sale of such products.

We are subject to the highly cyclical nature of the networking and telecommunications markets.

Our products are incorporated into routers, switches, wireless local area network infrastructure equipment, wireless base stations and network access equipment used in the highly cyclical networking and telecommunications markets. We expect that the networking and telecommunications markets will continue to be highly cyclical, characterized by periods of rapid growth and contraction. Our business and our operating results are likely to fluctuate, perhaps quite severely, as a result of this cyclicity.

The market for Very Fast SRAMs is highly competitive.

The market for Very Fast SRAMs, which are used primarily in networking and telecommunications equipment, is characterized by price erosion, rapid technological change, cyclical market patterns and intense foreign and domestic competition. Several of our competitors offer a broad array of memory products and have greater financial, technical, marketing, distribution and other resources than we have. Some of our competitors maintain their own semiconductor fabrication facilities, which may provide them with capacity, cost and technical advantages over us. We cannot assure you that we will be able to compete successfully against any of these competitors. Our ability to compete successfully in this market depends on factors both within and outside of our control, including:

- real or perceived imbalances in supply and demand of Very Fast SRAMs;
- the rate at which OEMs incorporate our products into their systems;
- the success of our customers' products;
- our ability to develop and market new products; and
- the supply and cost of wafers.

In addition, we are vulnerable to advances in technology by competitors, including new SRAM architectures and new forms of DRAM, or the emergence of new memory technologies that could enable the development of products that feature higher performance, lower cost or lower power capabilities. Additionally, the trend toward incorporating SRAM into other chips in the networking and telecommunications markets has the potential to reduce future demand for Very Fast SRAM products. There can be no assurance that we will be able to compete successfully in the future. Our failure to compete successfully in these or other areas could harm our business.

The average selling prices of our products are expected to decline, and if we are unable to offset these declines, our operating results will suffer.

Historically, the average unit selling prices of our products have declined substantially over the lives of the products, and we expect this trend to continue. A reduction in overall average selling prices of our products could result in reduced revenues and lower gross margins. Our ability to increase our net revenues and maintain our gross margins despite a decline in the average selling prices of our products will depend on a variety of factors, including our ability to introduce lower cost versions of our existing products, increase unit sales volumes of these products, and introduce new products with higher prices and greater margins. If we fail to accomplish any of these objectives,

our business will suffer. To reduce our costs, we may be required to implement design changes that lower our manufacturing costs, negotiate reduced purchase prices from our independent foundries and our independent assembly and test vendors, and successfully manage our manufacturing and subcontractor relationships. Because we do not operate our own wafer foundry or assembly facilities, we may not be able to reduce our costs as rapidly as companies that operate their own foundries or facilities.

Global economic and market conditions may adversely affect our business, financial condition and results of operations.

We sell our products to end customers both in the United States and internationally. We also rely heavily on our suppliers in Asia. We are therefore susceptible to adverse domestic and international economic and market conditions. In recent years, turmoil in global financial markets and economic conditions has impacted credit availability, consumer spending and capital expenditures, including expenditures for networking and telecommunications equipment. Weakness in global networking and telecommunications markets, particularly in Asia, has continued to adversely impact our revenues in recent quarters. Slowness in economic growth, domestically and in our key markets, uncertainty regarding macroeconomic trends, and volatility in financial markets may continue to adversely affect our business, financial condition and results of operations over coming quarters.

We are dependent on a number of single source suppliers, and if we fail to obtain adequate supplies, our business will be harmed and our prospects for growth will be curtailed.

We currently purchase several key components used in the manufacture of our products from single sources and are dependent upon supply from these sources to meet our needs. If any of these suppliers cannot provide components on a timely basis, at the same price or at all, our ability to manufacture our products will be constrained and our business will suffer. Most significantly, we obtain wafers for our Very Fast SRAM products from a single foundry, TSMC, and most of them are packaged at ASE. Wafers for our LLDRAM products are obtained exclusively from Powerchip. If we are unable to obtain an adequate supply of wafers from TSMC or Powerchip or find alternative sources in a timely manner, we will be unable to fulfill our customer orders and our operating results will be harmed. We do not have supply agreements with TSMC, Powerchip, ASE or any of our other independent assembly and test suppliers, and instead obtain manufacturing services and products from these suppliers on a purchase-order basis. Our suppliers, including TSMC and Powerchip, have no obligation to supply products or services to us for any specific product, in any specific quantity, at any specific price or for any specific time period. As a result, the loss or failure to perform by any of these suppliers could adversely affect our business and operating results.

Should any of our single source suppliers experience manufacturing failures or yield shortfalls, be disrupted by natural disaster or political instability, choose to prioritize capacity or inventory for other uses or reduce or eliminate deliveries to us for any other reason, we likely will not be able to enforce fulfillment of any delivery commitments and we would have to identify and qualify acceptable replacements from alternative sources of supply. In particular, if TSMC is unable to supply us with sufficient quantities of wafers to meet all of our requirements, we would have to allocate our products among our customers, which would constrain our growth and might cause some of them to seek alternative sources of supply. Since the manufacturing of wafers and other components is extremely complex, the process of qualifying new foundries and suppliers is a lengthy process and there is no assurance that we would be able to find and qualify another supplier without materially adversely affecting our business, financial condition and results of operations.

Because we outsource our wafer manufacturing and independent wafer foundry capacity is limited, we may be required to enter into costly long-term supply arrangements to secure foundry capacity.

We do not have long-term supply agreements with TSMC or Powerchip, but instead obtain our wafers on a purchase order basis. In order to secure future wafer supply from TSMC or Powerchip or from other independent foundries, we may be required to enter into various arrangements with them, which could include:

- contracts that commit us to purchase specified quantities of wafers over extended periods;

- investments in and joint ventures with the foundries; or
- non-refundable deposits with or prepayments or loans to foundries in exchange for capacity commitments.

We may not be able to make any of these arrangements in a timely fashion or at all, and these arrangements, if any, may not be on terms favorable to us. Moreover, even if we are able to secure independent foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

If we are unable to offset increased wafer fabrication costs by increasing the average selling prices of our products, our gross margins will suffer.

If there is a significant upturn in the networking and telecommunications markets that results in increased demand for our products and competing products, the available supply of wafers may be limited. As a result, we could be required to obtain additional manufacturing capacity in order to meet increased demand. Securing additional manufacturing capacity may cause our wafer fabrication costs to increase. If we are unable to offset these increased costs by increasing the average selling prices of our products, our gross margins will decline.

We rely heavily on distributors and our success depends on our ability to develop and manage our indirect distribution channels.

A significant percentage of our sales are made to distributors and to contract manufacturers who incorporate our products into end products for OEMs. For example, in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, our distributor Avnet Logistics accounted for 23.4%, 28.2%, 35.2% and 30.3%, respectively, of our net revenues. Avnet Logistics and our other existing distributors may choose to devote greater resources to marketing and supporting the products of other companies. Since we sell through multiple channels and distribution networks, we may have to resolve potential conflicts between these channels. For example, these conflicts may result from the different discount levels offered by multiple channel distributors to their customers or, potentially, from our direct sales force targeting the same equipment manufacturer accounts as our indirect channel distributors. These conflicts may harm our business or reputation.

We may be unable to accurately predict future sales through our distributors, which could harm our ability to efficiently manage our resources to match market demand.

Our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns of the OEMs that purchase our products from our distributors. While we attempt to assist our distributors in maintaining targeted stocking levels of our products, we may not consistently be accurate or successful. This process involves the exercise of judgment and use of assumptions as to future uncertainties, including end user demand. Inventory levels of our products held by our distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could result in distributors returning unsold inventory to us, or in us not having sufficient inventory to meet the demand for our products. If we are not able to accurately predict sales through our distributors or effectively manage our relationships with our distributors, our business and financial results will suffer.

A small number of customers generally account for a significant portion of our accounts receivable in any period, and if any one of them fails to pay us, our financial position and operating results will suffer.

At December 31, 2016, three customers accounted for 35%, 20% and 19% of our accounts receivable, respectively. If any of these customers do not pay us, our financial position and operating results will be harmed. Generally, we do not require collateral from our customers.

We have previously disclosed a material weakness in our internal control over financial reporting relating to the evaluation and calculation of our inventory reserve which management believes has been fully remediated. Should we have inadequately remediated this material weakness or should we otherwise fail to maintain effective internal control over financial reporting and disclosure controls and processes, our ability to report our financial condition and results of operations accurately and on a timely basis could be adversely affected.

In connection with the completion of the quarter-end closing and review procedures for the quarter ended December 31, 2013, certain errors were identified in the evaluation and calculation of our inventory write-down for the quarter and nine month period then ended that were the result of a material weakness in our internal control over financial reporting. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

During these closing and review procedures, our management determined that we had not designed and maintained effective controls over the review of supporting information to confirm the completeness and accuracy of our calculations for the write-down of excess or obsolete inventory, thereby affecting the valuation of our inventory as of December 31, 2013. While this control deficiency did not result in any material misstatement of our historical financial statements, it did result in adjustments identified by our auditors as part of their quarterly review process, and require corrections after our initial estimate of excess and obsolete inventory write-downs for the three month period ended December 31, 2013.

A material weakness in our internal control over financial reporting could adversely impact our ability to provide timely and accurate financial information. Following the identification of the error in our financial statements and the material weakness that gave rise to the error, our management implemented a remediation plan which it believes fully remediated the material weakness. Should our remediation efforts prove to have been inadequate or should we otherwise fail to maintain effective internal control over financial reporting and disclosure controls and procedures, we could be unable to meet our reporting obligations accurately and on a timely basis. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could adversely affect the trading price of our common stock.

Our acquisition of companies or technologies could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

In November 2015, we acquired all of the outstanding capital stock of privately held MikaMonu Group Ltd., a development-stage, Israel-based company that specializes in in-place associative computing for markets including big data, computer vision and cyber security. We also acquired substantially all of the assets related to the SRAM memory device product line of Sony Corporation in 2009. We intend to supplement our internal development activities by seeking opportunities to make additional acquisitions or investments in companies, assets or technologies that we believe are complementary or strategic. Other than the MikaMonu and Sony acquisitions, we have not made any such acquisitions or investments, and therefore our experience as an organization in making such acquisitions and investments is limited. In connection with the recently completed MikaMonu acquisition, we are subject to risks related to potential problems, delays or anticipated costs that may be encountered in the development of products based on the MikaMonu technology and the establishment of new markets and customer relationships for the potential new products. In addition, in connection with the MikaMonu acquisition and any future acquisitions or investments we may make, we face numerous other risks, including:

- difficulties in integrating operations, technologies, products and personnel;
- diversion of financial and managerial resources from existing operations;
- risk of overpaying for or misjudging the strategic fit of an acquired company, asset or technology;
- problems or liabilities stemming from defects of an acquired product or intellectual property litigation that may result from offering the acquired product in our markets;

- challenges in retaining key employees to maximize the value of the acquisition or investment;
- inability to generate sufficient return on investment;
- incurrence of significant one-time write-offs; and
- delays in customer purchases due to uncertainty.

If we proceed with additional acquisitions or investments, we may be required to use a considerable amount of our cash, or to finance the transaction through debt or equity securities offerings, which may decrease our financial liquidity or dilute our stockholders and affect the market price of our stock. As a result, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be harmed.

Claims that we infringe third party intellectual property rights could seriously harm our business and require us to incur significant costs.

In recent years, there has been significant litigation in the semiconductor industry involving patents and other intellectual property rights. We have recently been involved in protracted patent infringement litigation, and we could become subject to additional claims or litigation in the future as a result of allegations that we infringe others' intellectual property rights or that our use of intellectual property otherwise violates the law. Claims that our products infringe the proprietary rights of others would force us to defend ourselves and possibly our customers, distributors or manufacturers against the alleged infringement. Any such litigation regarding intellectual property could result in substantial costs and diversion of resources and could have a material adverse effect on our business, financial condition and results of operations. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. If any claims received in the future were to be upheld, the consequences to us could require us to:

- stop selling our products that incorporate the challenged intellectual property;
- obtain a license to sell or use the relevant technology, which license may not be available on reasonable terms or at all;
- pay damages; or
- redesign those products that use the disputed technology.

Although patent disputes in the semiconductor industry have often been settled through cross-licensing arrangements, we may not be able in any or every instance to settle an alleged patent infringement claim through a cross-licensing arrangement in part because we have a more limited patent portfolio than many of our competitors. If a successful claim is made against us or any of our customers and a license is not made available to us on commercially reasonable terms or we are required to pay substantial damages or awards, our business, financial condition and results of operations would be materially adversely affected.

Our business will suffer if we are unable to protect our intellectual property.

Our success and ability to compete depends in large part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws and non-disclosure and other contractual agreements to protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement. Monitoring unauthorized use of our intellectual property is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Our attempts to enforce our intellectual property rights could be time consuming and costly. We were recently involved in litigation to enforce our intellectual property rights and to protect our trade secrets. Additional litigation of this type may be necessary in the future. Any such litigation could result in substantial costs and diversion of resources. If

competitors are able to use our technology without our approval or compensation, our ability to compete effectively could be harmed.

We may experience difficulties in transitioning to smaller geometry process technologies and other more advanced manufacturing process technologies, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

In order to remain competitive, we expect to continue to transition the manufacture of our products to smaller geometry process technologies. This transition will require us to migrate to new manufacturing processes for our products and redesign certain products. The manufacture and design of our products is complex, and we may experience difficulty in transitioning to smaller geometry process technologies or new manufacturing processes. These difficulties could result in reduced manufacturing yields, delays in product deliveries and increased expenses. We are dependent on our relationships with TSMC and Powerchip to transition successfully to smaller geometry process technologies and to more advanced manufacturing processes. We cannot assure you that TSMC or Powerchip will be able to effectively manage the transition or that we will be able to maintain our relationship with them. If we or TSMC or Powerchip experience significant delays in this transition or fail to implement these transitions, our business, financial condition and results of operations could be materially and adversely affected.

Manufacturing process technologies are subject to rapid change and require significant expenditures for research and development.

We continuously evaluate the benefits of migrating to smaller geometry process technologies in order to improve performance and reduce costs. Historically, these migrations to new manufacturing processes have resulted in significant initial design and development costs associated with pre-production mask sets for the manufacture of new products with smaller geometry process technologies. For example, in fiscal 2014, we incurred \$809,000 and \$648,000, respectively, in research and development expense associated with pre-production mask sets which were not later used in production as part of the transition to our new 40 nanometer SRAM process technology and 63 nanometer DRAM process technology. We will incur similar expenses in the future as we continue to transition our products to smaller geometry processes. The costs inherent in the transition to new manufacturing process technologies will adversely affect our operating results and our gross margin.

Our products are complex to design and manufacture and could contain defects, which could reduce revenues or result in claims against us.

We develop complex products. Despite testing by us and our OEM customers, design or manufacturing errors may be found in existing or new products. These defects could result in a delay in recognition or loss of revenues, loss of market share or failure to achieve market acceptance. These defects may also cause us to incur significant warranty, support and repair costs, divert the attention of our engineering personnel from our product development efforts, result in a loss of market acceptance of our products and harm our relationships with our OEM customers. Our OEM customers could also seek and obtain damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

Defects in wafers and other components used in our products and arising from the manufacturing of these products may not be fully recoverable from TSMC or our other suppliers. For example, in the quarter ended December 31, 2005, we incurred a charge of approximately \$900,000 related to the write-off of inventory resulting from an error in the assembly process at one of our suppliers. This write-off adversely affected our operating results for fiscal 2006.

Demand for our products may decrease if our OEM customers experience difficulty manufacturing, marketing or selling their products.

Our products are used as components in our OEM customers' products, including routers, switches and other networking and telecommunications products. Accordingly, demand for our products is subject to factors affecting the ability of our OEM customers to successfully introduce and market their products, including:

- capital spending by telecommunication and network service providers and other end-users who purchase our OEM customers' products;
- the competition our OEM customers face, particularly in the networking and telecommunications industries;
- the technical, manufacturing, sales and marketing and management capabilities of our OEM customers;
- the financial and other resources of our OEM customers; and
- the inability of our OEM customers to sell their products if they infringe third-party intellectual property rights.

As a result, if OEM customers reduce their purchases of our products, our business will suffer.

Our products have lengthy sales cycles that make it difficult to plan our expenses and forecast results.

Our products are generally incorporated in our OEM customers' products at the design stage. However, their decisions to use our products often require significant expenditures by us without any assurance of success, and often precede volume sales, if any, by a year or more. If an OEM customer decides at the design stage not to incorporate our products into their products, we will not have another opportunity for a design win with respect to that customer's product for many months or years, if at all. Our sales cycle can take up to 24 months to complete, and because of this lengthy sales cycle, we may experience a delay between increasing expenses for research and development and our sales and marketing efforts and the generation of volume production revenues, if any, from these expenditures. Moreover, the value of any design win will largely depend on the commercial success of our OEM customers' products. There can be no assurance that we will continue to achieve design wins or that any design win will result in future revenues.

Any significant order cancellations or order deferrals could adversely affect our operating results.

We typically sell products pursuant to purchase orders that customers can generally cancel or defer on short notice without incurring a significant penalty. Any significant cancellations or deferrals in the future could materially and adversely affect our business, financial condition and results of operations. Cancellations or deferrals could cause us to hold excess inventory, which could reduce our profit margins, increase product obsolescence and restrict our ability to fund our operations. We generally recognize revenue upon shipment of products to a customer. If a customer refuses to accept shipped products or does not pay for these products, we could miss future revenue projections or incur significant charges against our income, which could materially and adversely affect our operating results.

If our business grows, such growth may place a significant strain on our management and operations and, as a result, our business may suffer.

We are endeavoring to expand our business, and any growth that we are successful in achieving could place a significant strain on our management systems, infrastructure and other resources. To manage such growth of our operations and resulting increases in the number of our personnel, we will need to invest the necessary capital to continue to improve our operational, financial and management controls and our reporting systems and procedures. Our controls, systems and procedures may prove to be inadequate should we experience significant growth. In addition, we may not have sufficient administrative staff to support our operations. For example, we currently have only five employees in our finance department in the United States, including our Chief Financial Officer. Furthermore, our officers have limited experience in managing large or rapidly growing businesses. If our management fails to respond effectively to changes in our business, our business may suffer.

Our international business exposes us to additional risks.

Products shipped to destinations outside of the United States accounted for 62.7%, 60.3%, 66.2% and 69.2% of our net revenues in the nine months ended December 31, 2016 and in fiscal 2016, 2015 and 2014, respectively. Moreover, a substantial portion of our products is manufactured and tested in Taiwan, and we are now conducting business operations in Israel as a result of our recently completed acquisition of MikaMonu. We intend to continue expanding our international business in the future. Conducting business outside of the United States subjects us to additional risks and challenges, including:

- heightened price sensitivity from customers in emerging markets;
- compliance with a wide variety of foreign laws and regulations and unexpected changes in these laws and regulations;
- legal uncertainties regarding taxes, tariffs, quotas, export controls, competition, export licenses and other trade barriers;
- potential political and economic instability in, or foreign conflicts that involve or affect, the countries in which we, our customers and our suppliers are located;
- difficulties in collecting accounts receivable and longer accounts receivable payment cycles;
- difficulties and costs of staffing and managing personnel, distributors and representatives across different geographic areas and cultures, including assuring compliance with the U. S. Foreign Corrupt Practices Act and other U. S. and foreign anti-corruption laws;
- limited protection for intellectual property rights in some countries; and
- fluctuations in freight rates and transportation disruptions.

Moreover, our reporting currency is the U.S. dollar. However, a portion of our cost of revenues and our operating expenses is denominated in currencies other than the U.S. dollar, primarily the New Taiwanese dollar. As a result, appreciation or depreciation of other currencies in relation to the U.S. dollar could result in transaction gains or losses that could impact our operating results. We do not currently engage in currency hedging activities to reduce the risk of financial exposure from fluctuations in foreign exchange rates.

TSMC and Powerchip, as well as our other independent suppliers and many of our OEM customers have operations in the Pacific Rim, an area subject to significant earthquake risk and adverse consequences related to the potential outbreak of contagious diseases such as the H1N1 Flu.

The foundries that manufacture our Fast SRAM and LLDRAM products, TSMC and Powerchip, and all of the principal independent suppliers that assemble and test our products are located in Taiwan. Many of our customers are also located in the Pacific Rim. The risk of an earthquake in these Pacific Rim locations is significant. The occurrence of an earthquake or other natural disaster near the fabrication facilities of TSMC or our other independent suppliers could result in damage, power outages and other disruptions that impair their production and assembly capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling, packaging or production testing from the affected contractor to another third-party vendor. In such an event, we may not be able to obtain alternate foundry capacity on favorable terms, or at all.

The outbreak of SARS in 2003 curtailed travel to and from certain countries, primarily in the Asia-Pacific region, and limited travel within those countries. If there were to be another outbreak of a contagious disease, such as SARS or the H1N1 Flu, that significantly affected the Asia-Pacific region, the operations of our key suppliers could be disrupted. In addition, our business could be harmed if such an outbreak resulted in travel being restricted,

as it was during parts of 2003, or if it adversely affected the operations of our suppliers or our OEM customers or the demand for our products or our OEM customers' products.

Changes in Taiwan's political, social and economic environment may affect our business performance.

Because much of the manufacturing and testing of our products is conducted in Taiwan, our business performance may be affected by changes in Taiwan's political, social and economic environment. For example, any political instability resulting from the relationship among the United States, Taiwan and the People's Republic of China could damage our business. Moreover, the role of the Taiwanese government in the Taiwanese economy is significant. Taiwanese policies toward economic liberalization, and laws and policies affecting technology companies, foreign investment, currency exchange rates, taxes and other matters could change, resulting in greater restrictions on our ability and our suppliers' ability to do business and operate facilities in Taiwan. If any of these changes were to occur, our business could be harmed and our stock price could decline.

We are substantially dependent on the continued services and performance of our senior management and other key personnel.

Our future success is substantially dependent on the continued services and continuing contributions of our senior management who must work together effectively in order to design our products, expand our business, increase our revenues and improve our operating results. Members of our senior management team have long-standing and important relationships with our key customers and suppliers. The loss of services of Lee-Lean Shu, our President and Chief Executive Officer, Robert Yau, our Vice President of Engineering, any other executive officer or other key employee could significantly delay or prevent the achievement of our development and strategic objectives. We do not have employment contracts with, nor maintain key person insurance on, any of our executive officers.

If we are unable to recruit or retain qualified personnel, our business and product development efforts could be harmed.

We must continue to identify, recruit, hire, train, retain and motivate highly skilled technical, managerial, sales and marketing and administrative personnel. Competition for these individuals is intense, and we may not be able to successfully recruit, assimilate or retain sufficiently qualified personnel. We may encounter difficulties in recruiting and retaining a sufficient number of qualified engineers, which could harm our ability to develop new products and adversely impact our relationships with existing and future end-users at a critical stage of development. The failure to recruit and retain necessary technical, managerial, sales, marketing and administrative personnel could harm our business and our ability to obtain new OEM customers and develop new products.

We may need to raise additional capital in the future, which may not be available on favorable terms or at all, and which may cause dilution to existing stockholders.

We may need to seek additional funding in the future. We do not know if we will be able to obtain additional financing on favorable terms, if at all. If we cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, and we may be required to reduce operating costs, which could seriously harm our business. In addition, if we issue equity securities, our stockholders may experience dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

Some of our products are incorporated into advanced military electronics, and changes in international geopolitical circumstances and domestic budget considerations may hurt our business.

Some of our products are incorporated into advanced military electronics such as radar and guidance systems. Military expenditures and appropriations for such purchases rose significantly in recent years. However, as the current conflict in Afghanistan winds down, demand for our products for use in military applications may decrease, and our operating results could suffer. Domestic budget considerations may also adversely affect our

operating results. For example, if governmental appropriations for military purchases of electronic devices that include our products are reduced, our revenues will likely decline.

Our operations involve the use of hazardous and toxic materials, and we must comply with environmental laws and regulations, which can be expensive, and may affect our business and operating results.

We are subject to federal, state and local regulations relating to the use, handling, storage, disposal and human exposure to hazardous and toxic materials. If we were to violate or become liable under environmental laws in the future as a result of our inability to obtain permits, human error, accident, equipment failure or other causes, we could be subject to fines, costs, or civil or criminal sanctions, face property damage or personal injury claims or be required to incur substantial investigation or remediation costs, which could be material, or experience disruptions in our operations, any of which could have a material adverse effect on our business. In addition, environmental laws could become more stringent over time imposing greater compliance costs and increasing risks and penalties associated with violations, which could harm our business.

We face increasing complexity in our product design as we adjust to new and future requirements relating to the material composition of our products, including the restrictions on lead and other hazardous substances that apply to specified electronic products put on the market in the European Union, China and California. Other countries, including at the federal and state levels in the United States, are also considering similar laws and regulations. Certain electronic products that we maintain in inventory may be rendered obsolete if they are not in compliance with such laws and regulations, which could negatively impact our ability to generate revenue from those products. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, or in the worst case decreased revenue, and could even require that we redesign or change how we manufacture our products. Such redesigns result in additional costs and possible delayed or lost revenue.

The trading price of our common stock is subject to fluctuation and is likely to be volatile.

The trading price of our common stock may fluctuate significantly in response to a number of factors, some of which are beyond our control, including:

- actual or anticipated declines in operating results;
- changes in financial estimates or recommendations by securities analysts;
- the institution of legal proceedings against us or significant developments in such proceedings;
- announcements by us or our competitors of financial results, new products, significant technological innovations, contracts, acquisitions, strategic relationships, joint ventures, capital commitments or other events;
- changes in industry estimates of demand for Very Fast SRAM products;
- the gain or loss of significant orders or customers;
- recruitment or departure of key personnel; and
- market conditions in our industry, the industries of our customers and the economy as a whole.

In recent years the stock market in general, and the market for technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. The market price of our common stock might experience significant fluctuations in the future, including fluctuations unrelated to our performance. These fluctuations could materially adversely affect our business relationships, our ability to obtain future financing on favorable terms or otherwise harm our business. In addition, in the past, securities class action litigation has often been brought against a company following periods of volatility

in the market price of its securities. This risk is especially acute for us because the extreme volatility of market prices of technology companies has resulted in a larger number of securities class action claims against them. Due to the potential volatility of our stock price, we may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources. This could harm our business and cause the value of our stock to decline.

Use of a portion of our cash reserves to repurchase shares of our common stock presents potential risks and disadvantages to us and our stockholders.

From November 2008 through December 2016, we repurchased and retired an aggregate of 11,983,942 shares of our common stock at a total cost of \$60.6 million, including 3,846,153 shares repurchased at a total cost of \$25 million pursuant to a modified "Dutch auction" self-tender offer that we completed in August 2014 and additional shares repurchased in the open market pursuant to our stock repurchase program. At December 31, 2016, we had outstanding authorization from our Board of Directors to purchase up to an additional \$4.4 million of our common stock from time to time under our repurchase program. Although our Board has determined that these repurchases are in the best interests of our stockholders, they expose us to certain risks including:

- the risks resulting from a reduction in the size of our "public float," which is the number of shares of our common stock that are owned by non-affiliated stockholders and available for trading in the securities markets, which may reduce the volume of trading in our shares and result in reduced liquidity and, potentially, lower trading prices;
- the risk that our stock price could decline and that we would be able to repurchase shares of our common stock in the future at a lower price per share than the prices we have paid in our tender offer and repurchase program; and
- the risk that the use of a portion of our cash reserves for this purpose has reduced, or may reduce, the amount of cash that would otherwise be available to pursue potential cash acquisitions or other strategic business opportunities.

Our executive officers, directors and entities affiliated with them hold a substantial percentage of our common stock.

As of January 31, 2017, our executive officers, directors and entities affiliated with them beneficially owned approximately 34% of our outstanding common stock. As a result, these stockholders will be able to exercise substantial influence over, and may be able to effectively control, matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could have the effect of delaying or preventing a third party from acquiring control over or merging with us.

The provisions of our charter documents might inhibit potential acquisition bids that a stockholder might believe are desirable, and the market price of our common stock could be lower as a result.

Our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock. Our Board of Directors can fix the price, rights, preferences, privileges and restrictions of the preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock might delay or prevent a change in control transaction. As a result, the market price of our common stock and the voting and other rights of our stockholders might be adversely affected. The issuance of preferred stock might result in the loss of voting control to other stockholders. We have no current plans to issue any shares of preferred stock. Our charter documents also contain other provisions, which might discourage, delay or prevent a merger or acquisition, including:

- our stockholders have no right to remove directors without cause;
- our stockholders have no right to act by written consent;
- our stockholders have no right to call a special meeting of stockholders; and

·stockholders must comply with advance notice requirements to nominate directors or submit proposals for consideration at stockholder meetings.

These provisions could also have the effect of discouraging others from making tender offers for our common stock. As a result, these provisions might prevent the market price of our common stock from increasing substantially in response to actual or rumored takeover attempts. These provisions might also prevent changes in our management.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**Stock Repurchase Program**

Our Board of Directors has authorized us to repurchase, at management's discretion, shares of our common stock. Under the repurchase program, we may repurchase shares from time to time on the open market or in private transactions. The specific timing and amount of the repurchases will be dependent on market conditions, securities law limitations and other factors. The repurchase program may be suspended or terminated at any time without prior notice. Below is summary of the repurchases of our common stock made during the quarter ended December 31, 2016, all of which were made under our repurchase program:

<u>Period</u>	<u>Shares Repurchased</u>	<u>Average Price per Share</u>	<u>Value of Shares That May Yet Be Repurchased Under the Repurchase Program</u>
Beginning approximate dollar value available to be repurchased as of September 30, 2016			\$ 4,858,258
October 1 to October 31, 2016	100,000	\$ 4.95	\$ 4,363,758
November 1 to November 30, 2016	—	\$ —	\$ 4,363,758
December 1 to December 31, 2016	—	\$ —	\$ 4,363,758
Total shares repurchased	<u>100,000</u>		
Ending approximate dollar value that may be repurchased as of December 31, 2016			<u>\$ 4,363,758</u>

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Item 6. *Exhibits*

<u>Exhibit Number</u>	<u>Name of Document</u>
31.1	Certification of Lee-Lean Shu, President, Chief Executive Officer and Chairman, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Douglas M. Schirle, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Lee-Lean Shu, President, Chief Executive Officer and Chairman, and Douglas M. Schirle, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

EXHIBIT INDEX

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**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Lee-Lean Shu, certify that:

1. I have reviewed this quarterly report on Form 10-Q of GSI Technology, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 3, 2017

/s/ LEE-LEAN SHU

Lee-Lean Shu

President, Chief Executive Officer and Chairman

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Douglas M. Schirle, certify that:

1. I have reviewed this quarterly report on Form 10-Q of GSI Technology, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 3, 2017

/s/ DOUGLAS M. SCHIRLE

Douglas M. Schirle

Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of GSI Technology, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned officers of the Company, each certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 3, 2017

/s/ LEE-LEAN SHU

Lee-Lean Shu

President, Chief Executive Officer and Chairman

/s/ DOUGLAS M. SCHIRLE

Douglas M. Schirle

Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.
